No. 77-1373

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

MAINE CENTRAL RAILROAD COMPANY, *Appellant*

v.

RAYMOND L. HALPERIN, et al., *Appellees*

On Appeal from the Supreme Judicial Court of Maine

MOTION TO DISMISS OR AFFIRM

CLIFFORD B. OLSON
Assistant Attorney General
State of Maine
Department of the Attorney General
State House
Augusta, Maine 04333
(207) 289-2076

Attorney for Raymond L. Halperin, Joseph E. Brennan and the State of Maine

April 26, 1978

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1373

MAINE CENTRAL RAILROAD COMPANY, *Appellant*

v.

RAYMOND L. HALPERIN, et al., *Appellees*

On Appeal from the Supreme Judicial Court of Maine

MOTION TO DISMISS OR AFFIRM

Appellees move the Court to dismiss this appeal or affirm the judgment of the Supreme Judicial Court of Maine on the ground that the appeal does not present a substantial federal question.

QUESTIONS PRESENTED

1. Whether inclusion of incentive per diem charges in the computation of the Maine railroad excise tax frustrates the federal incentive per diem program and, therefore, violates the supremacy clause of the Constitution.

2. Whether the Maine railroad excise tax fails to reasonably apportion appellant's interstate business activities and, therefore, violates the commerce clause or the due process clause of the Constitution.

STATEMENT

Maine Central Railroad Company (Maine Central) is a Maine corporation which, in 1974, operated 765 miles of railroad in Maine and a total of 143 miles in New Hampshire, Vermont, and New Brunswick. Because of its operations in Maine, the railroad was subject to the Maine railroad excise tax, 36 M.R.S.A. §§ 2623 *et seq.*, a franchise tax levied in lieu of property tax on the land and fixtures within the railroad's located right-of-way (R. 39).

The tax base of the Maine railroad excise tax is the railroad's "gross transportation receipts" (GTR).[1] The tax rate is governed by the ratio of the railroad's "net railway operating income" (NROI) to its gross transportation receipts; as the ratio increases, the rate increases, in ½ percent increments, from 3¼ percent to 5¼ percent. The tax determined by application of the appropriate rate to the railroad's gross transportation receipts is then "diminished" by the amount by which 5¾ percent of the sum of railway property used in transportation service (less depreciation), cash (including temporary cash investments and special deposits), and material and supplies exceeds the railroad's net railway operating income. This diminution factor is the critical element in determining a railroad's excise tax liability since, in many cases, the amount of tax initially determined would be reduced to zero. Under that circumstance, the minimum tax of ¼ of 1 percent of gross transportation receipts takes effect. 36 M.R.S.A. § 2624. The diminished tax

[1] The tax base is not the totality of a railroad's gross receipts as appellant erroneously states (Jur. St. 4-5, 6-7). The appendix to this motion outlines the relationship of railway accounting terms.

or minimum tax, whichever is applicable, is then apportioned by the ratio of the railroad's Maine miles to total system miles to determine the final tax.[2]

This case originated in Maine Central's attempt to exclude certain revenue from the computation of its Maine railroad excise tax for 1974 since reporting of its income in the usual manner would substantially increase the railroad's tax liability for that year. Because of its high level of 1974 earnings, the railroad became subject to nearly the full effect of a 3¾ percent tax rate rather than to the minimum rate to which it had grown accustomed. To justify a reduction in liability, the railroad claimed that the Maine railroad excise tax statute did not contemplate the inclusion of so-called "incentive per diem" (IPD) freight car rental income in the tax computation formula because the use of that income was restricted by the Interstate Commerce Commission (ICC).

The "numerous restrictions" cited by Maine Central (Jur. St. 9, 14) are essentially two — the "earmarking" and "quota" provisions. "Earmarking" requires that IPD funds be used only for boxcar acquisitions and payment of income tax attributable to IPD income. 49 C.F.R. § 1036.3 (1976). Under the "quota" restriction, a railroad, prior to using IPD funds, must have acquired, for each year the IPD program has been in effect, the average number of boxcars which it acquired in the 1964-68 "test period". 49 C.F.R. § 1036.4 (1976).

Upon the State Tax Assessor's refusal to accept Maine Central's proposed exclusion of IPD revenues from the tax formula, the railroad brought an action

[2] A chart illustrating the operation of the Maine railroad excise tax appears at R. 186.

for declaratory judgment in the Superior Court of Kennebec County, Maine. In addition to its statutory construction argument, Maine Central alleged that inclusion of IPD revenues in the tax computation would unconstitutionally frustrate the federal boxcar acquisition program and burden interstate commerce. The action was reported on an agreed statement of facts to the Supreme Judicial Court of Maine.

The Supreme Judicial Court found that, although the IPD credit balance is earmarked for boxcar acquisitions and therefore bears some of the characteristics of a trust fund, it confers a direct and substantial benefit upon the IPD creditor railroads, who, upon expenditure of the restricted funds, become the outright owners of the acquired boxcars. *Maine Central R.R. v. Halperin,* 379 A.2d 980, 984 (Me., 1977) (Jur. St. 8a). Consequently, IPD revenues were properly included in the computation formula used to value Maine Central's franchise.

The court below further concluded, notwithstanding the obvious fact that an increased tax liability would reduce the taxpayer's general corporate funds, that Maine Central had shown neither inability nor disincentive to participate in the IPD program. 379 A.2d at 986-987. (Jur. St. 11a-14a). Moreover, even Maine Central's unlikely withdrawal from boxcar acquisitions would not frustrate the federal program because the ICC has specifically provided for use of the restricted funds under those circumstances. 379 A.2d at 987-988 (Jur. St. 14a-16a). Thus, an implied prohibition of state taxation was unwarranted.

Finally, the court below rejected the concept that a state, in levying a franchise tax, must apportion each individual item which comprises the value of the fran-

chise. The court did not minimize the importance of fair apportionment, as Maine Central charges (Jur. St. 13), but, rather, determined that the bulk of Maine Central's franchise value is located in Maine and therefore is appropriately apportioned to Maine. *Maine Central R.R. v. Halperin,* 381 A.2d 8, 11 (Me., 1977) (Jur. St. 28a-29a). Accordingly, the Supreme Judicial Court denied the relief sought by Maine Central and granted the defendants' counterclaim for the contested amount of tax plus statutory interest.

ARGUMENT

1. Inclusion of incentive per diem income in the computation of the Maine railroad excise tax does not frustrate the federal incentive per diem program and, therefore, does not violate the supremacy clause of the Constitution.

The Supreme Judicial Court of Maine adhered completely to the precedents of this Court in determining, on the facts, that imposition of the Maine railroad excise tax did not frustrate the full effectiveness of the federal incentive per diem program.

Maine Central attempts to discredit the decision below by attributing to the ICC an express intent that the IPD program should not create any burden, however indirect, upon a railroad's general corporate funds (Jur. St. 14, 19). However, no such intent appears in the record in any official form; appellant relies for this point only upon the speculation of an employee of the ICC (R. 202). The ICC did expressly provide relief by allowing railroads to use restricted IPD funds to pay incremental federal and state income taxes attributable to the earning of IPD revenues (R. 124). However, as the court below concluded, the fact that the ICC has granted this relief and none other suggests that the commission considers neither direct income

taxation of the restricted IPD fund nor the imposition of other IPD-related liabilities upon general corporate funds to frustrate the federal program. 379 A.2d at 988n.12 (Jur. St. 17a n.12). Where the intent of Congress and federal regulatory agencies is so uncertain, this Court has avoided taking irrevocable action against the state. *Penn Dairies v. Milk Control Commission of Pennsylvania*, 318 U.S. 261, 275 (1943). We submit that such a course is proper in this case.

The decision below was essentially a factual determination that inclusion of the IPD credit balance in the computation of the Maine railroad excise tax does not interfere with the federal IPD program. This result finds overwhelming support in the record, as follows:

1. The inclusion of IPD credits in the computation of the Maine railroad excise tax for 1974 does not impair the ability of Maine Central to participate in the IPD program. The State of Maine recognized, of course, that payment of the excise tax from the restricted IPD fund would directly conflict with the IPD program. Accordingly, the state proposed that the tax be paid from the railroad's general corporate funds.

Maine Central's general corporate funds were sufficient, at least in 1975 when the excise tax was due, to pay the entire tax, contrary to the suggestions (Jur. St. 20-21; R. 200; R. 207) of appellant and its witnesses. As stipulated, Maine Central's unrestricted ordinary income for 1974 was $1,004,105, substantially in excess of the $615,000 incremental tax resulting from inclusion of IPD revenues in the tax computation formula (R. 37-38). Moreover, on December 31, 1974, Maine Central had working capital of over $5 million, including temporary cash investments of $5,365,000

(R. 39). Thus, payment of the full tax would in no way have impaired Maine Central's capital assets, as alleged in the railroad's complaint (R. 15).

Maine Central has failed to show that the excise tax assessed by the State of Maine would prevent its compliance with the quota requirement, 49 C.F.R. § 1036.4 (1976), which is a prerequisite to the expenditure of restricted IPD funds. Maine Central's quota was never introduced into evidence; the quota could conceivably be zero or so low that it would constitute no impediment. Moreover, a freight car study conducted by the ICC indicated that nine of the fifteen leading per diem creditor railroads either exclusively purchased new boxcars or exclusively rebuilt old boxcars during the 1964-68 test period. *Incentive Per Diem Charges — 1968*, 337 I.C.C. 183, 192, 212 (1969) (R. 55, 75). This suggests that, for many railroads, the quota requirement is meaningless. A railroad in this position could have free access to restricted IPD funds by using the opposite acquisition method from that which it employed in 1964-68 (e.g. by rebuilding boxcars if it had exclusively purchased boxcars in 1964-68). Thus, the court below validly rejected Maine Central's quota arguments. 379 A.2d at 987 (Jur. St. 14a).

2. The inclusion of IPD credits in the Maine railroad excise tax computation for 1974 has not demonstrably reduced Maine Central's incentive to participate in the IPD program. To the contrary, the record strongly suggests that Maine Central is heavily engaged in the IPD program notwithstanding its pending excise tax liability. The railroad leased 250 boxcars in August, 1974 (p. 20 of *Maine Central Railroad Company Annual Report - 1975*, transmitted *in specie* as Exhibit Q to Agreed Statement of Facts). In addi-

tion, Maine Central rebuilt 100 boxcars in 1974-75 (62 in 1975) through the use of IPD funds (*Id.*, p. 10). Finally, the railroad made a commitment in November, 1975 for the acquisition of 500 new boxcars — in itself a 15.9 percent increase in Maine Central's boxcar fleet (*Id.*).

3. Maine Central's 1974 excise tax liability was an anomaly, caused by the railroad's highest earnings in its 112-year history (p. 3 of Maine Central *1974 Annual Report*, transmitted *in specie* as Exhibit P to Agreed Statement of Facts). In most situations, inclusion of the IPD credit balance in the tax computation does not affect the amount of Maine railroad excise tax liability. In this regard, the Supreme Judicial Court of Maine concluded that:

> because incentive per diem charges as such are not taxed by the excise tax but, rather, are merely included in the computation by which the applicable rate becomes determined, an increase of incentive funds need not necessarily produce a greater excise tax liability. 379 A.2d at 986 (Jur. St. 12a).

The conclusion is supported not only by examination of the mechanics of the tax (R. 186) but also by stipulated facts. Maine Central's excise tax liability for the years 1970-1973 was not changed by the inclusion of IPD credits in the computations (R. 40-41). For 1975, Maine Central's excise tax liability as assessed was $67,174 (R. 39), which is shown by simple arithmetic to result from application of the minimum tax rate of 1/4 of 1 percent to the railroad's gross transportation receipts of $31,892,172 (R. 189, lines 1-4) and apportionment of the result by the 84.25 percent mileage factor. In addition, since the beginning of the IPD program, no other railroad operating in Maine has experienced an increase in excise tax liability because of the

inclusion of IPD credits in the tax computation (R. 41).

4. Finally, while Maine Central has not established either a present or future disability or disincentive to participate in the IPD program, the court below nevertheless took into account the possibility of such an event. The Supreme Judicial Court correctly noted that the ICC itself had actively planned for such a contingency by providing alternatives[3] to ensure that all IPD funds will be spent on boxcar acquisitions. 379 A.2d at 987-988 (Jur. St. 14a-15a). Thus, the federal IPD program cannot be frustrated by an individual railroad's action.

The recommendation of the court below that Maine Central use its financial planning resources to develop strategies for optimal participation in the IPD program, 379 A.2d at 988 (Jur. St. 16a), is the necessary product of the railroad's having presented only vague predictions of financial disaster, unsubstantiated by concrete financial analysis. The railroad did not meet its burden of proving frustration of the federal program because such suggestions are a direct contradiction of Maine Central's documented participation in boxcar acquisitions. When the court below has clearly followed the precedents of this Court and the evidence so strongly supports the result, we submit that the question presented is too insubstantial to warrant further argument.

---

[3] A railroad may surrender unused IPD funds to Rail Box Corporation. 49 C.F.R. § 1036.4 (1976). If a railroad does not use the funds, obtain relief from the ICC, or surrender the funds to Rail Box within 18 months after the end of the year in which they were collected, the ICC will investigate and take appropriate corrective action. *Id.*

2. The Maine railroad excise tax reasonably apportions appellant's interstate business activity and, therefore, does not violate either the commerce clause or the due process clause of the Constitution.

The present Maine railroad excise tax cannot be distinguished from that upheld by this Court in *Maine v. Grand Trunk Ry.*, 142 U.S. 217 (1891). *Grand Trunk* held that the value of the privilege of exercising the railroad's franchises in Maine was validly measured by reference to the railroad's gross transportation receipts. 142 U.S. at 228-229. As explained in *Galveston, H. & S.A. Ry. v. Texas*, 210 U.S. 217 (1908), the *Grand Trunk* taxing system contemplated the exemption of the railroad's right-of-way from property taxation and replacement of that tax with an excise tax on the property value of the franchise in those states in which the railroad operated a right-of way. 210 U.S. at 226. The apportionment formula, in turn, was based upon the assumption that the franchise value was equally distributed along the railroad's right-of-way. *Id.* Although the tax rate is now determined by the ratio of net railway operating income to gross transportation receipts rather than by the average GTR per mile and the tax initially computed is now subject to diminution, the basic concept of the tax remains the same. 379 A.2d at 990 (Jur. St. 20a-21a).

Maine Central's emphasis on the apportionment of net railway operating income (Jur. St. 24, 27) is misplaced. The apportionment of NROI, in itself, is inconsequential to the fairness of the apportionment of the entire Maine railroad excise tax. NROI controls the amount of the tax (by affecting the tax rate and the amount of diminution) and not the apportionment of the tax. The property value of the franchise, rather than NROI, is the subject of apportionment. In the

Maine railroad excise tax upheld in *Grand Trunk, supra*, apportionment of the tax was achieved by apportioning gross transportation receipts on the basis of mileage and multiplying Maine GTR by the tax rate. 142 U.S. at 218n.1. The same result would have been attained by multiplying total GTR by the tax rate and apportioning the product by the mileage factor. The similarity of the existing apportionment provision to the *Grand Trunk* provision suggests that the Maine Legislature, to avoid having to rewrite the entire statute upon adoption of the gross-net method of taxation, apportioned NROI to allow it to be compared with GTR on equal terms. *See* 36 M.R.S.A. § 2624. Since the mileage factor is applied to both NROI and GTR, the effect is no different than if NROI and GTR were compared at full value to determine the tax rate and NROI and 5¾ percent of railroad investment were compared at full value to determine the diminution amount. By the latter method, the full franchise value is determined and then apportioned on the basis of mileage to arrive at the same tax as that which results from separate apportionment of each element of the tax. Thus, the apportionment issue in this case is not whether NROI is properly apportioned but whether the mileage factor reasonably distributes the value of the privilege taxed.

Maine Central's reliance on *Norfolk & Western Ry. v. Missouri State Tax Commission*, 390 U.S. 317 (1968), is also inappropriate. In *Norfolk*, this Court overturned an ad valorem property tax because the mileage apportionment formula produced a grossly distorted representation of the actual location of the railroad's rolling stock. As the Supreme Judicial Court of Maine concluded, 381 A.2d at 10 (Jur. St. 26a-27a), the tangible property involved in *Norfolk* (including its augmented going-concern value) could be specific-

ally identified and shown not to be equally distributed along Norfolk & Western's line. On the other hand, the value of Maine Central's franchise was augmented by freight car movements throughout the continent, but no evidence was presented to show that the franchise value itself was distributed other than equally along the railroad's right-of-way. 381 A.2d at 11n.2 (Jur. St. 28a n.2).

Even if part of Maine Central's franchise value were located outside those jurisdictions in which it operated a right-of-way, the railroad did not establish that that part of the franchise value must be apportioned to jurisdictions other than those in which it operated a right-of-way. Maine Central's right-of-way lies only in Maine, New Hampshire, Vermont and New Brunswick. No showing has been made that Maine Central had any contact in 1974 with any other state or province except for the random movement of some of its cars through some of those states and provinces on the tracks of other railroads because of mandatory interchange. This Court's holding in *Central R.R. of Pennsylvania v. Pennsylvania*, 370 U.S. 607 (1962) strongly suggests that such tenuous contact does not confer nexus for taxation. In *Central*, the domiciliary state was allowed to levy an ad valorem property tax on the unapportioned value of a railroad's rolling stock where the railroad showed that part of its rolling stock was absent from the domiciliary state for part of the year but failed to show either that the rolling stock traveled fixed and regular routes through particular non-domiciliary states or that a substantial part of the rolling stock was habitually employed in particular non-domiciliary states. 370 U.S. at 615. To the extent that such activity does not produce a situs for property tax purposes, we believe it does not produce a nexus for franchise taxation.

Moreover, even under Maine Central's theory that the Maine railroad excise tax is a tax on gross receipts as such, the apportionment result would not have been that sought by the railroad. This Court has held that such taxes are to be apportioned to reflect the taxpayer's activity in the taxing state. *Gwin, White & Prince v. Henneford*, 305 U.S. 434, 439 (1939). Maine Central would like to create the impression that freight car rentals, which are the basis for IPD revenues, constitute the bulk of its business activity. However, the net railway operating income account is a false indicator of the railroad's business activity. Examination of the railroad's income account (p. 14 of Maine Central's *1974 Annual Report*, transmitted *in specie* as Exhibit P to Agreed Statement of Facts) shows that Maine Central had $36,199,711 in gross revenues ($34,135,-977 "total railway operating revenues" plus $2,063,734 "net rents") in 1974. The bulk of Maine Central's business activity involved the hauling of freight, which accounted for $33,435,409, or 92.4 percent, of the railroad's gross revenues (*Id.*). By contrast, freight car rentals ($2,714,947),[4] the entire subject of this commerce clause and due process clause appeal, constituted only 7.5 percent of Maine Central's gross revenues for 1974. The railroad has not even attempted to show that any of the remaining 92.5 percent of Maine Central's activity is malapportioned. Thus, even if freight car rental revenues were apportioned in accordance with Maine Central's arguments, only a small change in the overall apportionment formula would be warranted. Moreover, the apparent lack of nexus demon-

[4] "Hire of freight cars" is part of the "net rents" account. Maine Central's total net rents for 1974 were less than freight car rental credits because the railroad had a debit balance in its "joint facility rents" account.

strated above casts serious doubt on whether even the freight car rental income (7.5 percent of gross revenues) would have to be apportioned in accordance with the location of Maine Central's freight cars when those revenues were earned.

Since net railway operating income is a net profit figure, apportionment by the locus of the elements of NROI, as advocated by Maine Central (Jur. St. 24, 27), would constitute a weighting of business activity to reflect profitability. Maine Central has cited no authority for the proposition that the Constitution of the United States requires such a weighted apportionment. Even if this novel concept were adopted, the exact apportionment would not be that suggested by the railroad. Freight car rental credits merely appear to be responsible for 80 percent of Maine Central's 1974 NROI because, under ICC accounting regulations, all operating expenses and taxes (other than taxes related to extraordinary items) are applied against "total railway operating revenues". The result ("total railway operating income") is added to "net rents", a gross revenue account,[5] to determine NROI (p. 14 of *1974 Annual Report*). Under this accounting format, none of the expenses which are fairly attributable to net rents (e.g. freight car depreciation for the period of time during which the car is earning IPD credits) are applied against that income. Thus, downward adjustment of freight car rental income as a percentage of net railway operating income would be necessary to accurately apportion the profitability of Maine Central's activities.

---

[5] "Net rents" is essentially a gross revenue account, since "net" refers only to the offset of rental credits against rental debits. 49 C.F.R. 1201 (account no. 503)

Maine Central has failed to show, both under the Supreme Judicial Court's characterization of the tax and under its own, that the mileage apportionment formula generally approved for taxation of transportion companies, *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 663 (1948), *Canton R.R. v. Rogan*, 340 U.S. 511, 515-516 (1951), yielded, for 1974, a grossly distorted result of the kind condemned in *Norfolk & Western Ry. v. Missouri State Tax Commission, supra*. The railroad does not raise a substantial constitutional question but, rather, a pro-forma objection to the significant increase in tax liability which resulted when the railroad's profits overran the statutory relief provisions which ordinarily reduce Maine Central's railroad excise tax to the minimum.

CONCLUSION

For the reasons set out above, the Court should dismiss this appeal or affirm the judgment of the Supreme Judicial Court of Maine.

Respectfully submitted,

CLIFFORD B. OLSON
Assistant Attorney General
State of Maine
Department of the Attorney General
State House
Augusta, Maine 04333
(207) 289-2076
Attorney for Raymond L. Halperin, Joseph E. Brennan and the State of Maine

April 26, 1978

APPENDIX

RELATIONSHIP OF RAILWAY ACCOUNTING TERMS[1]

	Maine Central 1974 operations
GROSS TRANSPORTATION RECEIPTS (GTR)	
Freight	$33,435,409
Passenger	1,450
Switching	90,363
Other Transportation	3,092
	$33,530,314
RAILWAY OPERATING REVENUES	
GROSS TRANSPORTATION RECEIPTS	$33,530,314
Incidental	583,563
Joint Facility	22,100
	$34,135,977
RAILWAY OPERATING EXPENSES	
Maintenance of Way and Structures	$ 7,378,763
Maintenance of Equipment	7,154,641
Traffic	519,352
Transportation	12,062,295
General	2,042,841
	$29,157,892

[1] Source: Maine Central *1974 Annual Report* (transmitted *in specie* as Exhibit P to Agreed Statement of Facts) p. 14, supplemented by plaintiff's 1974 Maine railroad excise tax return (R. 180)

NET RENTS		
Hire of Freight Cars		$ 2,714,947
Other Equipment Rents		3,395
Joint Facility Rents		(654,608)
		$ 2,063,734
NET RAILWAY OPERATING INCOME (NROI)		
RAILWAY OPERATING REVENUES		$34,135,977
NET RENTS		2,063,734
		$36,199,711
Less:		
RAILWAY OPERATING EXPENSES		$29,157,892
Taxes:		
Railway Tax Accruals		3,575,726
Prov. for Deferred Taxes		60,840
		$32,794,458
		$ 3,405,253